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Economic Update

AUGUST 2, 2021

CHANDAN ECONOMICS

1. GDP: MISSING THE MARK

- GDP grew at a 6.5% seasonally adjusted annualized rate (SAAR) during Q2 2021, according to advance estimates from the Commerce Department. The growth is an improvement from the previous quarter's 6.3% SAAR, but it still underperformed expectations. According to Bloomberg's latest survey of economists, the median forecast had expected an 8.4% SAAR. Reasons for the undershoot were declines in residential investment and inventories as well as declines in federal spending.
- Personal consumption expenditures (PCE) increased a notable 11.8% between Q1 2021 and Q2 2021, led by spending on accommodation and food services as reopening efforts took place nationwide. Accommodation and food services made up the most significant contribution to GDP growth of any single category, adding 2.24 percentage points to total GDP growth.
- Evidence points to the beginning of a drawdown in personal savings built up during the pandemic. Personal savings dropped to $1.97 trillion SAAR in Q2 2021 from over $4 trillion SAAR in the first quarter.

2. VTS OFFICE DEMAND

- According to the VTS Office Demand Index (VODI), a monthly measure of real-time tenant demand in the U.S. Office leasing market, demand surged 43.3% between the first and second quarters of 2021 and is now only 14% below its 2018-2019 average.
- After contracting by as much as 84% below its pre-pandemic benchmark in June 2020, office demand has steadily risen. Employers are increasingly basing their return-to-office decisions on their anticipated need for on-site work instead of COVID-19 safety concerns.
- Cities with lower shares of remote-friendly jobs are leading those with higher shares in their office market's recovery. Los Angeles, Chicago, and New York, which all have close to 1/3rd of their employees working in remote-friendly jobs, have recovered 99%, 85%, and 98% of their pre-pandemic office demand, respectively.
- Meanwhile, Boston, Seattle, and San Francisco, where roughly four out of every ten workers are employed in a remote-friendly job, have seen a much slower recovery, recovering just 56%, 66%, and 67%, respectively. Washington D.C. breaks this trend, recovering 75% of its pre-pandemic office demand despite having 42% of its workforce in remote-friendly positions.

3. COMMERCIAL REAL ESTATE PRICES

- According to the Real Capital Analytics Commercial Property Price Index, commercial real estate valuations are up 9.8% year-over-year through June 2021. On average, valuations did not fall during last year's shutdown, but rather, price growth stalled. Of course, outcomes varied widely by property type. Compared to February 2020 levels, the price index is up by 10.1%.

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- Office properties located in central business districts (CBD) continue to lag behind in the recovery, with average prices down 2.4% year-over-year through June. Prices for CBD office assets remain down 2.9% from their February 2020 peak. Meanwhile, suburban office assets continue to push new highs as prices are up 7.7% year-over-year.
- Unsurprisingly, the asset types posting the most robust year-over-year price changes are apartment and industrial. Through June, apartment assets are up by 12.0% year-over-year. Industrial follows close behind with price growth totaling 9.8% over the same period.
- The retail sector, which entered the pandemic already in a period of dislocation and structural softness, has started to see some positive momentum. Through June, prices are up 3.2% year-over-year. Moreover, they are up 4.0% from their low point observed in September of last year.

4. CAP RATES

- According to Real Capital Analytics, cap rates across commercial real estate remain lowest in apartment properties, averaging 4.9% through Q2 2021. Apartment cap rates are down 5 bps from the previous quarter and 29 bps year-over-year. Garden apartment assets continue to see significant cap rate compression, declining 63 bps year-over-year and 31 bps quarter-over-quarter to land at 5.1%.
- Hotel assets have, on average, seen the most cap rate compression over the past year than any other property type. Through Q2 2021, hotel cap rates are averaging 8.3%, down 29 bps from one year earlier. These data partially reflect base effects, as the hotel sector was the only core commercial property type to see widening cap rates in 2020, albeit marginally.
- The industrial sector continued its string of solid performance, posting cap rate declines of 29 bps year-over-year, settling at 5.7% through Q2 2021. The office and retail sectors both recorded declining average cap rates through the second quarter as well. Office assets led the field with the most significant quarter-over-quarter drop, declining 8 bps to land at 6.4%. Meanwhile, retail assets have average cap rates down 3 bps quarter-over-quarter and 8 bps year-over-year, coming in at 6.6%.

5. GOOGLE MOBILITY TRENDS

- According to data from Google's Community Mobility Reports, which measures visitors (or duration of a visit) against a pre-COVID baseline, mobility has generally improved since January 2021, when the U.S. recorded over 300,000 cases in a single day.
- Month-to-date data through July 25th show that visits to retail and recreation places, including destinations such as bars and restaurants, are down only 4.0% on average relative to its pre-COVID baseline. Meanwhile, visits to grocery stores and pharmacies surpassed their baselines by 4.0%. Both activities have made considerable improvements since January 2021, when retail and recreation places were 25.6% below their

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pre-pandemic baseline while grocery stores and pharmacies were 13.7% below.

- Visits to transit stations, including destinations such as subway stations and taxi stands, are still down 15.8% on average relative to their pre-COVID baseline but seem to be improving every month. The July average is a substantial improvement since visits to transit stations were 40.7% below their pre-pandemic baseline in January.
- Workplace visits make up the only category to have seen little improvement since January. Partial July data shows it as down by 27.7%, about where things stood in January 2021.

6. ADVANCE RETAIL SALES

- According to the Census Bureau's Advance Retail Sales estimates, retail and food services sales totaled $621.3 billion in June 2021. Sales expanded by $3.4 billion (0.6%) from the month prior, and $94.7 billion (18.0%) year-over-year. A notable portion of the annual gain is due to rapid increases in prices observed over the past year. Through June 2021, CPI notched a 5.4% year-over-year growth rate.
- Perhaps not surprisingly, spending at food service and drinking places has been picking up. In June, the category made up only 11% of total expenditures but contributed 47% of the monthly gain. Monthly gains for non-store retailers have slowed since the height of the pandemic but remain 34% above February 2020 levels.

7. HOUSING STARTS, PERMITS, AND CONFIDENCE

- According to the Census Bureau and Department of Housing and Urban Development's latest joint data release, seasonally adjusted housing starts increased 6.3% to 1.64 million units annualized between May and June 2021. Housing starts are up 29.1% over the last year, even though starts have decreased after reaching their post-Great Financial Crisis peak during March.
- Seasonally adjusted housing permits fell 5.1% to 1.60 million annualized between May and June 2021, the lowest issuance since last November. Though still up a significant 29.1% from June 2020, the monthly slowdown in permits relative to the number of starts could indicate that homebuilding will slow down from its elevated levels.
- The permit slowdown coincides with elevated costs for homebuilding and dropping builder confidence. The National Association of Homebuilders/Wells Fargo Housing Market Index reached its lowest levels since August 2020, another indication that starts could begin to moderate. June's index reading of 80 is still well above the 50 needed to indicate that builders view the market as being more favorable.

8. NFIB SMALL BUSINESS SURVEY

- The composite Small Business Optimism Index, compiled by the National Federation of Independent

Businesses, rose 2.9 points to 102.5 in June. It is the highest reading since November 2020 and puts the index within reach of the 104.5 level seen in February 2020, just prior to the pandemic's widespread economic fallout.

- Small businesses are raising prices. A net 47% of owners, the highest level in over 40 years, indicated they raised prices over the last three months, and a net 44% indicate they will raise prices over the next three months. The price increases come as widespread reports of labor and input costs increases remain prevalent, and consumer inflation expectations are rising.
- Firms want to hire, but many are reporting difficulties. 46% of respondents said they had job openings they could not fill during June, doubling the historical average. A net 28% of owners reported that they are looking to create new jobs over the next three months. Amid the labor challenges being reported, 39% of small businesses reported raising compensation, but only 9% of respondents with lower profits cited labor costs as a driver.

9. CONSUMER CONFIDENCE INDEX

- Consumer confidence remains in positive flux, though it appears to be stabilizing, according to the latest measure of The Conference Board's Consumer Confidence Index. The index rose modestly from 128.9 in June to 129.1 in July. While momentum has slowed, the index has risen in six consecutive months, signaling consumers' increasing willingness to make purchases as public health concerns subside. Confidence levels are at their highest since February 2020 (132.6), a month before COVID-related shutdowns began.
- The Present Situation Index, a sub-component that measures consumers' view of current business and labor market conditions, rose slightly in July from 159.6 to 160.3.
- The Expectations Index, a sub-component that measures consumers' short-term outlook on income, business, and labor market conditions, remained relatively unchanged at 108.4, down just 0.1 index points from June.

10. COVID CASES & VACCINATIONS

- The 7-day average of daily COVID-19 cases in the U.S. was 66,924 on July 28th, its highest level since April 19th. While well below peak levels, the trend points to a worsening national outlook as the more infectious Delta variant has caused a spike in cases. The spike is most prevalent in southern and lower midwestern states, with Louisiana currently seeing the highest rate of transmission at 77 cases per 100,000 residents. Infections are relatively low in Northeastern and upper Midwestern states, though every state is reporting at least a modest uptick.
- Roughly 49% of the U.S. population is fully vaccinated. However, rates vary greatly state-to-state, and state vaccination rates negatively correlate with case counts. Vermont maintains the highest share of vaccinations,

with 67% of residents fully vaccinated. Alabama and Mississippi share the lowest rate of vaccinations, with just 34% of residents fully vaccinated. While cases in Vermont have increased 157% over the past 14 days, Alabama and Mississippi have seen 265% and 272% increases, respectively, over the same period.

- Unvaccinated people make up the bulk share of new coronavirus cases. However, there are nationwide reports of fully vaccinated individuals testing positive in what are called "breakthrough" cases. Experts say that breakthroughs remain relatively uncommon, though data on the phenomenon remains scarce.

SUMMARY OF SOURCES

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